In the Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-65

JOHN B. WHITE, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. App. A2-A14) is reported at 55 T.C. 729. The *per curiam* opinion of the court of appeals (Pet. App. A15) is reported at 458 F.2d 989.

JURISDICTION

The judgment of the court of appeals was entered on April 24, 1972. (Pet. App. A16.) The petition for

a writ of certiorari was filed on July 12, 1972. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the courts below properly found that an amount paid by the Ford Motor Company to petitioner, one of its franchised dealers, was not excludible from petitioner's gross income as a contribution to capital under Section 118 of the Internal Revenue Code of 1954.

STATUTES INVOLVED

Internal Revenue Code of 1954 (26 U.S.C.):

> SEC. 61. GROSS INCOME DEFINED.
>
> (a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived * * *.
>
> * * * * *
>
> SEC. 118. CONTRIBUTIONS TO THE CAPITAL OF A CORPORATION.
>
> (a) *General Rule.*—In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.
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> * * * * *

STATEMENT

On February 1, 1955, the petitioner ("White"), and the Ford Motor Company ("Company") entered into a Ford Sales Agreement which authorized White to operate a Ford dealership at 4920 North Broad

Street, Philadelphia, Pennsylvania. Ford owned none of White's stock. Under their agreement, Ford agreed to act as the manufacturer-supplier of Ford automobiles, parts, and accessories, and to provide White with experience and technical knowledge to assist White in selling and servicing Ford products. White was required (1) to sell and service Ford products in a manner satisfactory to Ford and to conduct its business "in a manner that will reflect favorably at all times on" Ford, its products, and its reputation; (2) to "establish, maintain, and equip a place or places of business, including a salesroom, service facilities and a used passenger automobile and truck outlet, in a manner satisfactory to [Ford] * * * and display conspicuously thereat an assortment of Ford signs reasonably satisfactory to [Ford] * * *;" (3) to employ adequate trained personnel, to maintain an accounting system acceptable to Ford, to furnish Ford a monthly financial statement, to maintain a stock of new automobiles and parts and accessories, and (4) to maintain regular contact with Ford owners in the area. The agreement specified that the requirements imposed upon White were intended to "protect the good name, good will and reputation of Company, to assure Company that its products will be made available to the public and that service facilities will be made available to users of its products." The agreement also provided that, unless otherwise agreed, White bore the financial responsibility for expenditures made by White to comply with the terms of the agreement. The agreement provided that it

did not establish an agency relationship between Ford and White. (Pet. App. A2-A6.)

White operated the Ford dealership at the 4920 North Broad Street address from February 1, 1955 until September 15, 1965. On June 14, 1965, Ford's district sales manager notified White by letter that Ford approved White's proposed relocation to 6600 North Broad Street, Philadelphia, and agreed "to pay [White] $59,290 in a lump sum for leasehold improvements and eligible premises assistance" and $20,000 for tools and equipment which it agreed to repurchase from White. As the parties stipulated, Ford agreed to make the $59,290 payment in order to increase the sales of its products and enhance its image by having the White dealership located in a more desirable neighborhood and in a more attractive and better equipped building. (Pet. App. A6-A7, A12.)

On September 16, 1965, White moved its business to 6600 North Broad Street. White spent $57,335.59 in 1965 and $2,051.45 in 1966 or a total of $59,387.04 for leasehold improvements at the new location. White received $79,290 from Ford in 1965. On its 1965 federal corporate income tax return, White reported as income the amount by which $20,000 exceeded its basis in the tools and equipment repurchased by Ford, but failed to include the $59,290 in income, crediting that amount instead to a leasehold improvement account, and reducing its basis in leasehold improvements accordingly. (Pet. App. A7-A8.)

The Tax Court affirmed the determination of the Commissioner that the incentive payment was taxable income, and that it was not excludible from gross income as a contribution to White's capital under Section 118 of the Internal Revenue Code of 1954. (Pet. App. A12-A14.) The court of appeals affirmed. (Pet. App. A15-A16.)

ARGUMENT

The decision below is correct, and there is no conflict or other reason for further review.

Petitioner does not challenge the ruling below that the incentive payment it received from Ford was income to it within the broad ambit of Section 61(a) of the Internal Revenue Code of 1954, *supra*, p. 2. It renews its contention, however, that the incentive payment was excludible from its gross income as a contribution to capital under Section 118(a) of the Code, *supra*, p. 2. Section 118 "in effect places in the code the court decisions" as to the circumstances under which a nonshareholder will be deemed to have made a contribution to a corporation's capital. S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 18-19. The earliest case cited by taxpayer (Pet. 5) is *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98, decided in 1943. There the question was whether electric power lines were depreciable, as a contribution to capital, where the taxpayer had required customers to pay for them as a prerequisite to receiving serv-

ice.[1] This Court held that the payments from customers for the power lines were payments for service, not contributions to capital, stating that (319 U.S. at 102-103) "it overtaxes imagination to regard the farmers and other customers who furnished these funds as makers either of donations or contributions to the Company."

Several years after *Detroit Edison*, the Fourth Circuit decided *Commissioner* v. *Arundel-Brooks Concrete Corp.*, 152 F. 2d 225. In that case, the taxpayer was a manufacturer of concrete who claimed depreciation on the full cost of a new plant, even though one of its suppliers had contributed $20,000 of the cost. The court held that the $20,000 was not includible in the taxpayer's basis for depreciation, overruling an earlier decision to the contrary involving the same facts and parties (129 F. 2d 762) in the light of the intervening decision in *Detroit Edison*.

The next important development in this area was this Court's decision in *Brown Shoe Co.* v. *Commissioner*, 339 U.S. 583. There, community groups donated buildings, equipment and money to the tax-

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[1] Under the 1939 Code, which governed *Detroit Edison* and all of the other basis cases discussed in the text, depreciation on contributions to capital was allowable without limitation as to the source of such contributions. Sections 113(a)(8)(B), (b)(1)(B) and 114(a). Thus, a contribution to a corporation's capital by a nonshareholder might be depreciable. This is not so under the 1954 Code; Section 362(c)(1) provides a zero basis for assets acquired by a corporation as a contribution to capital by a nonshareholder. See our Petition for a Writ of Certiorari in *Chicago, Burlington & Quincy Railroad Co.* v. *United States*, No. 72-90.

payer to induce it to locate and operate at locations beneficial to the community. Stressing that the donations were made to benefit the community at large, the Court held that they constituted contributions to capital assets, depreciable by the taxpayer. By contrast to *Detroit Edison*, the Court noted (339 U.S. at 591):

> Since in this case there are neither customers nor payments for service, we may infer a different purpose in the transactions between petitioner and the community groups. The contributions to petitioner were provided by citizens of the respective communities who neither sought nor could have anticipated any direct service or recompense whatever, their only expectation being that such contributions might prove advantageous to the community at large. * * *

The Court further distinguished *Arundel-Brooks* as a case where (339 U.S. at 591-592, n. 13):

> The construction of the concrete plant directly benefited the supplier of raw materials by insuring the use of its sole product by the taxpayer; the supplier was also served through a business affiliation with the parent of the wholly owned taxpayer in the form of an exclusive marketing arrangement which saved the supplier the expense of a sales organization.[2]

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[2] Another application of *Detroit Edison* is the ruling in *Denver & Rio Grande Western Railroad Co.* v. *Commissioner*, 32 T.C. 43, 45-46, affirmed on other grounds, 279 F. 2d 368 (C.A. 10), that the taxpayer railroad could not deduct on retirement of spur trackage the portion of the cost donated by shippers benefiting from the spurs. The Tax Court said, in

The last of the authorities invoked by petitioner is a recent 1954 Code case, *Federated Department Stores* v. *Commissioner*, 426 F. 2d 417 (C.A. 6). There a real estate developer made donations to the taxpayer to induce it to locate a store in a shopping center on the developer's land. The court held that the donations were excludible from the taxpayer's income as contributions to capital because any future benefits to the developer, as distinguished from the community, were (426 F. 2d at 421) "speculative" and "indirect" and did not have "a reasonable nexus with the services which it was the business of the recipient corporation to provide."[8]

In the case at bar, it is stipulated (Pet. App. A12) "that Ford made the incentive payment to White in order to derive the benefits which it expected to flow from the relocation of White's dealership: increased sales of Ford products and enhancement of the Ford

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applying *Detroit Edison* and distinguishing *Brown Shoe*, that the shippers' donations were (32 T.C. at 45-46) "part of the price of [the] service furnished them by the petitioner, not * * * gifts or contributions to it. * * * there is no indication of any community benefits being involved * * *."

[8] Petitioner does not rely upon *Chicago, Burlington & Quincy Railroad Co.* v. *United States*, 455 F. 2d 993 (Ct. Cl.), petition for certiorari pending (No. 72-90). In that case, the government had donated to the taxpayer-railroad improvements at highway-railroad intersections which were a part of the Federal highway program and not a significant increment to the taxpayer's working assets. Under those circumstances, the government contends that the Court of Claims erred in holding that the donations were a contribution to capital under *Brown Shoe*.

image." Ford expected to receive from White direct benefits, as manufacturer and supplier, in a sense similar to that in which the supplier looked to the taxpayer in *Arundel-Brooks Concrete Corp.* as a market for its raw materials. This Court in *Brown Shoe* noted that the decision in *Arundel-Brooks* was a proper application of *Detroit Edison.* The instant case, we submit, falls squarely within the rationale of *Arundel-Brooks* and *Detroit Edison.* The court of appeals correctly held that Ford's incentive payment to White was not a contribution to capital.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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